

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation into the operations and practices of Verizon (formerly GTE California Incorporated; with respect to its Individual) Case Basis contracts.

**FILED**  
**PUBLIC UTILITIES COMMISSION**  
**April 22, 2002**  
**San Francisco Office**  
**I.02-04-027**

**ORDER INSTITUTING INVESTIGATION**

Verizon is the successor corporation to GTE California Incorporated (GTEC), a telecommunications corporation providing products and services in California.<sup>1</sup> Commission Resolution No. T-16218, issued on December 3, 1998, ordered Verizon to obtain an outside auditor's review of its compliance with Commission requirements for governmental agency contracts. Resolution T-16218 placed Verizon on three years of probation beginning March 1, 1999 (later extended to May 1, 1999). The Resolution also provided that the Commission would not revoke Verizon's contracting authority for non-compliant government contracts which Verizon disclosed to the Commission prior to the beginning date of the probationary period after the audit. Verizon provided the results of the required audit to Commission staff, including a broader internal review of Verizon's practices conducted by a private law firm and by Arthur Andersen, LLP (Andersen). The documents produced on behalf of Verizon appear to reveal many violations of applicable Commission requirements.

This is a formal investigation of Verizon's practices in connection with the program of Individual Case Basis (ICB) contracts, and of Verizon's

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<sup>1</sup> For ease of reference, both corporations are referred to here as Verizon.

compliance with applicable statutes, orders and other regulations. This proceeding is initiated to review Verizon's audit and secure the result of our staff's verification and investigation on the extent of Verizon's violations. The issues in this proceeding are: (1) whether there have been violations (2) if there have been violations, how many there have been; (3) whether it is appropriate to adopt sanctions against Respondent (including whether Verizon should be placed under different rules for entering ICB contracts, or whether the probation should be modified and/or extended); and (4) whether the utility should continue to have ICB contracting flexibility under existing rules.

The Commission issued Resolution No. T-16218 on December 3, 1998. Among other matters addressed in the resolution, the Commission imposed an undercharge penalty, ordered Verizon to remit a fine of \$20,000 to the General Fund to cover the Commission's cost for preparing and presenting the resolution, and imposed an additional \$86,352 fine payable to the General Fund for failing to file a government contract within 15 days of the date of execution. The Resolution placed Verizon on three years probation to deter it from violating D. 91-07-010 and similar General Order (GO) 96-A provisions<sup>2</sup>, and warned the company that, if it were found to have violated GO 96-A within the three-year probation period, the Commission would consider revocation of its authority to execute contracts with any governmental agency.

The Commission also ordered Verizon to conduct a review of its compliance with the filing requirements of D. 91-07-010 and General Order 96-A for its governmental agency contracts. Subsequently, Verizon expanded the scope of the outside audit to include non-governmental contracts.<sup>3</sup> In May 1999, Verizon provided the results of its audit and internal review to the Commission.

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<sup>2</sup> General Order 96-A pertains to government contracts.

<sup>3</sup> Decision 94-09-065 allowed Verizon to file nongovernmental contracts under the procedures established in the decision.

Against the protests of companies that were competitors of Verizon, D.91-07-010 (40 CPUC 2<sup>nd</sup> 675) relaxed the long-standing requirement that Individual Case Basis contracts be reviewed and approved by the Commission before they become effective. The concern underlying the former Commission approval process was that telecommunications services for customers with complex or unique service arrangements not be priced below cost. Pricing below cost would be anticompetitive, and could result in ratepayers being responsible for Verizon's incremental revenue requirement shortfall.

In D.91-07-010, however, the Commission granted a request by Pacific Bell (and supported by Verizon) to allow individual case basis (ICB) contracts with government entities to become effective upon submission to the Commission. The Advice Letters and contracts were not to be open to public inspection, and the program was premised on the assumption that the utilities would dutifully meet all process requirements and file contracts that were fully cost-based, and that regulatory staff (then the Commission's Advisory and Compliance Division) would review the filings to ensure compliance. A formula for imposing sanctions for non-compliance, partly pegged to contract revenues, was adopted (40 CPUC 2d 675, 695-696), as a make-whole remedy.

Following the Commission's adoption of Resolution T-16218 on December 3, 1998, Verizon undertook an audit of its ICBs, communicating its initial findings to staff in March, 1999. The violations found by Verizon's retained outside investigators, O'Melveny & Meyers, LLP and Arthur Andersen, LLP, in reviewing the company's ICB operations, include the following types of irregularities:

- Contracts were not filed with the PUC via advice letter within the 15-day allotted time period.
- Contracts were never filed with the PUC.
- Customers were not billed for contracted services.

- Customers were underbilled.
- Customers were overbilled
- Customers were not billed for all Non-recurring Charges (NRCs).
- Customers received service before the original contract was executed.
- Customers received service before there was an approved contract.
- Customers received service on expired contracts.
- Contracted services were priced below cost in contracts.
- Customers received inappropriate credits.

Arthur Anderson reviewed 181 ICB contracts and reported on May 1, 1999 that it found compliance problems with regulatory requirements in 80 contracts. Four ICB contracts were not evaluated because Verizon could not supply the auditors with adequate supporting documents.

Appendix A lists materials that are currently in the Commission's possession. Pursuant to Public Utilities Code §583, we will make these materials public beginning 30 days from the effective date of this order. Appendix B lists materials which we require Verizon to produce to our Consumer Services Division (CSD) within 30 days from the effective date of this order.

From the information supplied by Verizon to the Commission, the high number of potential violations of GO 96-A, along with the possibility that Verizon's conduct may have caused harm to the competitive market, appears to warrant scrutiny in a formal proceeding. Our purpose in initiating this formal proceeding is, aside from quantifying the full range of violations, if any, to consider whether any special conditions should be imposed on Verizon to better ensure that violations do not recur. Resolution T-16218 placed Verizon on "probation" for three years, and an issue in this proceeding is whether Verizon

should be placed under different rules for entering ICB contracts or whether the probation should be modified and extended.

The Commission will require verification of the adequacy of the Arthur Andersen review performed for Verizon, to determine whether it fully captured the scope of potential violations. The Commission has a duty to inquire into the results of the utility's internal audit in this situation, rather than taking them at face value. While Verizon did come forward with findings from its expanded audit, this does not alter the need to assess the extent of violations and evaluate whether the corrective actions take by Verizon to address the corporate management problems are adequate to prevent recurrence. The formal investigatory proceeding will create a public record, and is the appropriate forum to address serious potential violations of applicable laws and regulations.

We understand that discussions took place between CSD and Verizon relating to a possible settlement of the issues presented in this Investigation. While there is nothing improper about CSD communicating with the subjects of its investigations, we wish to emphasize that no settlement can be considered final or binding absent formal Commission approval in an open proceeding. Without a Commission decision approving a settlement, there is not a settlement. Accordingly, and consistent with our Rule 51.9, no prior settlement discussions, or related documents, will be disclosed, discoverable or admissible in this proceeding absent the agreement of both CSD and Verizon.

We find that there is good cause to institute an investigation of Verizon's operations and practices with respect to ICB contracts. This proceeding is directed at Verizon's conduct, and will not be a forum to assess customers' motives, roles or conduct in the course of their business transactions with Verizon. The utility, Verizon, knew of GO 96-A's requirements and it had the duty to follow them.

**IT IS ORDERED** that:

1. An investigation is instituted into the operations and practices of Verizon, formerly GTE California Incorporated (Verizon), regarding its operations and practices related to Individual Case Basis contracting.

2. This investigatory proceeding will determine if there have been violations, and, if so, how many, of (a) Commission Rules of Practice and Procedure, including Rule 1, and (b) requirements related to Verizon's Individual Case Basis contracting, including, but not limited to, requirements set out in D. 91-07-010 and General Order 96-A. A full quantification of violations, including any related Rule 1 violations, will be advanced after the ordered audit/review is completed.

3. Verizon is ordered to produce the documents listed in Appendix B within 30 days.

4. CSD staff shall retain and supervise outside consultants to undertake a review of Verizon's findings and subsequent corrective actions, if any, and also to independently review Verizon's ICB contracting programs. Verizon shall reimburse the Commission for these contracting expenses.

5. This paragraph suffices for the "preliminary scoping memo" required by Rule 6 (c) of the Commission's Rules of Practice and Procedure. This enforcement proceeding is categorized as an adjudicatory proceeding, and will be set for evidentiary hearing. The issues of this proceeding are framed in the above order. A hearing may also be held on any settlement, for the purpose of enabling parties to justify that it is in the public interest or to answer questions from the Administrative Law Judge or assigned Commissioner about settlement terms. A prehearing conference shall be scheduled by the assigned Commissioner or ALJ. This order, as to categorization of this proceeding, can be appealed under the procedures outlined in Rule 6.4. Any person filing a response to this order instituting investigation shall state in the response any objections to the order

regarding the need for hearings, or the issues to be considered. However, objections regarding issues to be considered must be confined to jurisdictional issues, rather than the factual assertions that are the subject of evidentiary hearings.

6. We expect Verizon to cooperate in good faith in the discovery process. We will not allow requests for information about other companies in the industry. This investigation concerns Verizon, and, to the extent that they may be involved, its affiliated and/or associated companies. CSD staff will be subject only to discovery relating to the specific violations alleged in this proceeding. No prior settlement discussions, or related documents, will be disclosed, discoverable or admissible in this proceeding absent the agreement of both CSD and Verizon.

7. Appendix A lists materials that are currently in the Commission's possession. Pursuant to Public Utilities Code §583, we order that the information identified in Appendix A be made public, beginning 30 days from the effective date of this order.

8. This Order Instituting Investigation puts Verizon on notice that it may be fined under the provisions of Public Utilities Code §§ 2107, 2108, and 2109 for any violations of the Public Utilities Code or of any order, decision, rule, direction, or requirement of the Commission. The Commission will also be considering whether any other sanctions or Commission action would be appropriate.

9. This order shall be served by mail on Verizon's regulatory representative Jenny Wong at 711 Van Ness Ave., Suite 300, San Francisco, Calif. 94102, its counsel, Ira Raphaelson, (O'Melveny & Meyers at 555 13<sup>th</sup> Street N.W., Washington, D.C. 20004-1109). It shall also be personally served on Verizon's agent for service of process in California.

This order is effective on the date that it is issued.

Dated April 22, 2002, at San Francisco, California.

LORETTA M. LYNCH

President

HENRY M. DUQUE

CARL W. WOOD

GEOFFREY F. BROWN

MICHAEL R. PEEVEY

Commissioners



## **ATTACHMENT A**

**VERIZON DOCUMENTATION**

1. Report on Results of Review of Individual Case Basis Contracts (ICBs) Process and Procedures, By O'Melveny & Myers LLP, May 5, 1999.
2. Exhibits to Report on Results of Review of Individual Case Basis Contracts (ICBs) Process and Procedures, Volume 4 (containing Exhibits 85 through 110), Undated.
3. Letter from O'Melveny & Myers LLP to CSD with Acronym Appendix attached, May 7, 1999.
4. Supplemental Report on Results of Review of Individual Case Basis Contracts (ICBs) Process and Procedures, (includes attachments) By O'Melveny & Myers LLP, (including attachments) June 16, 1999.
5. Analysis Of Internal Audit Function and Reporting Regarding ICBs, By O'Melveny & Myers LLP, May 5, 1999.
6. Exhibits for Analysis Of Internal Audit Function and Reporting Regarding ICBs, (containing Exhibits 1 through 24) By O'Melveny & Myers LLP, May 5, 1999.
7. ICB Contract Review – Penalty Calculation, Submitted to the Public Utilities Commission of the State of California (Consumer Services Division) and (Telecommunications Division – Carrier Branch), Arthur Andersen LLP, May 1, 1999 (4-page report and 59 pages of spreadsheets).

8. Letter from Arthur Andersen regarding "Correction to Penalty Calculation Dated May, 1999 on Behalf of GTE California Incorporated," June 15, 1999.
9. Compliance letter from O'Melveny & Myers LLP to CSD with four Advice Letters and one contract attached, November 18, 1999.
10. Compliance letter from O'Melveny & Myers LLP to CSD with three Advice Letters and one letter attached, December 14, 1999.
11. Compliance letter from O'Melveny & Myers LLP to CSD with Advice Letters, customer list, letter and Compliance Resolution Status Summaries attached, January 11, 2000.
12. Compliance letter from O'Melveny & Myers LLP to CSD with Advice Letter attached, January 20, 2000.
13. Compliance letter from O'Melveny & Myers LLP to CSD with two Advice Letters and Compliance Resolution Status Summary, Additional Issues Reported to CSD (Sorted by Customer) (02/08/2000) attached, February 8, 2000. Footnote No. 1 on page 2, relating to proposed settlement language, will be redacted.
14. Compliance letter from O'Melveny & Myers LLP to CSD with 14 attachments, April 25, 2000.
15. Compliance letter from O'Melveny & Myers LLP to CSD with Compliance Resolution Status Summary, Additional Issues Reported to CSD (Sorted by

Customer Name) (08/10/2000) and Compliance Resolution Status  
Summary, Additional Issues Reported to CSD (Sorted by Advice Letter)  
attached, August 10, 2000.

16. Compliance Resolution Status Summary, Additional Issues Reported to  
CSD (Sorted by Advice Letter), September 25, 2000.

17. Compliance letter from O'Melveny & Myers LLP to CSD June 7, 2001.

## **ATTACHMENT B**

**DOCUMENTS VERIZON IS ORDERED TO PRODUCE**

1. May 1, 1999, Arthur Andersen Report (10 pages plus 9 pages of exhibits.)
2. May 5, 1999 Two sets of Arthur Andersen Calculations, (each includes 4 page cover letter, plus 7 page calculation.)
3. May 5, 1999, Documents accompanying O'Melveny & Myers Report of Results of Review of ICB Process and Procedures:
  - a. 100 exhibits;
  - b. Appendices, volumes 1 through 4; and
  - c. 51 exhibits to the contract appendix.
4. May 14, 1999 Arthur Andersen Supplemental Report (3 pages plus 10 pages of exhibits.)
5. August 5, 1999 Letter to CSD, 1 page plus attached advice letter.
6. August 19, 1999 Letter to CSD, 2 pages plus attached advice letter.
7. August 24, 1999 Letter to CSD, 1 page plus attached advice letter.
8. September 9, 1999 Letter to CSD, 3 pages plus 3 advice letters.
9. November 2, 1999 Letter to CSD, 3 pages plus 5 attachments.
10. November 2, 1999 Letter to CSD, 3 pages plus 5 attachments
11. November 18, 1999 Letter to CSD, 3 pages plus 5 attachments
12. June 16, 2000 Letter to Telecommunications Division, 12 pages.